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AMERICAN NATIONAL BANK OF DENVER V. FIRST NATIONAL BANK OF DENVER AND HEREFORD STATE BANK *

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The Plaintiff, American National Bank of Denver, brought an action against Defendant, The Hereford State Bank, the first endorsee on the check in question, and Defendant, First National Bank of Denver, the intermediate endorsee which presented the check to the drawee—Plaintiff. The action arose when a depositor to the Plaintiff issued a check payable to two payees. When presented to Defendant Hereford, it bore the endorsement of only one of the payees. Thereafter, Hereford endorsed "Pay to the order of any bank, banker or Trust Company. Prior endorsements guaranteed," and transferred it to a bank in Cheyenne, Wyoming, not a party to the action, which endorsed to the Defendant, First National. The latter then presented the check for payment to the Plaintiff which paid the same and charged the account to its depositor. The drawee objected to the charge because of the missing endorsement and the bank reimbursed the account. The Plaintiff then began the action to recover the amount paid on the check.

The Complaint was based on two theories: that of the Negotiable Instruments Law,[1] and upon the allegation that payment to the Defendants was made "without consideration and paid by it to them by mistake." The Trial Court dismissed both claims against both Defendants. The Supreme Court affirmed as to the First National Bank, but reversed with respect to the second claim as to Hereford.

The Plaintiff relied upon the case of *Interstate Trust Company v. United States National Bank*,[2] to support a reversal of the dismissal of the First Claim with respect to both Defendants. The Court refused to base its decision upon the rather broad language of this decision which involved an altered check and was extremely cautious in its approach to the *Interstate* decision. The The Court went to great lengths to distinguish the case by stating that the following language was *dictum*:

> The drawee bank need concern itself with nothing but the genuineness of the signature, and the state of the account with it of the drawee.

Generally, it may be stated that a drawee bank must concern itself with its depositors' accounts and must know their signatures.[3] It is axiomatic that the drawee may not debit the account

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* ..... Colo. ....., 277 P. (2d) 951.

[1] Colorado Revised Statutes (1953), Chapter 95.

[2] 67 Colo. 6, 185 P. 260, 10 A.L.R. 705.

[3] Such a proposition is elementary and would appear to need no citation of authority. There may be an exception to the general rule which would occur when the depositor, by his course of conduct, negligence or laches has created a condition amounting to estoppel. See Denbigh v. First National Bank of Seattle, 102 Wash. 546, 174 P. 475.

of a depositor where a check has been forged or materially altered,[4] because the former may act only in accordance with the order or direction placed on the instrument by the latter. The Supreme Court, understandably, hesitated to extend the *dictum* of the *Interstate* case so as to hold that the *only* matters which must concern the drawee are those discussed above.

The action was not, however, one by the depositor against the drawee because of a debit of an account. Rather, it was an action to recover money remitted on this check to the Defendants.

Not only did Justice Alter refuse to rely upon the *Interstate Trust* case, but he would not base his decision upon the Negotiable Instruments Law. The decision held that since the check was not negotiated as defined by the Negotiable Instruments Law, the check in question ceased to be negotiable; since it was not negotiable, the rights and liabilities arising from the same could not be governed by the Negotiable Instruments Law. Although there is support for such reasoning it would appear more logical to reason that as long as the check complied with the requirements of the Negotiable Instruments Law as to the negotiable characteristics,[5] the instrument was negotiable. However, because it was not "negotiated," the rights and liabilities must arise independently of the N.I.L. which sets forth the obligations arising out of negotiation.[6]

The refusal of the Court to rule on the basis of the N.I.L. adds nothing to clarity. Cases arising out of situations where recovery is sought where money has been paid out in forged or altered instruments and forged endorsements, are not based primarily upon the N.I.L.[7] The problems have been treated as those encompassed within the fields of negligence and quasi contract generally, and the law of mistake specifically.

It is generally recognized that money paid out under mutual mistake of fact, may be recovered.[8] This principal was not extended, however, to negotiable instruments on which the signature

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[4] With respect to the altered check, there is authority substantiating the position that the drawee may charge the account for the amount of the check prior to alteration, if the alteration consisted of raising the instrument. National Bank of Commerce of New York v. National Mechanic's Banking Association of New York, 55 N.Y. 211, 14 Am. Rep. 232.

[5] Colo. Rev. Stat. (1953), Ch. 95, Art. 1, Secs. 1-9.

[6] Colo. Rev. Stat. (1953), Ch. 95, Art. 1, Secs. 63-69. If one of the payees failed to endorse, the instrument could not be negotiated as defined by the N.I.L. (Colo. Rev. Stat. (1953), Ch. 95, Art. 1, Sec. 30). If the instrument was not negotiated, and there was any transfer, the legal ramifications of the same cannot arise by virtue of the N.I.L.

[7] Price v. Neal, 3 Burr. 1354; Canal Bank v. Bank of Albany (N.Y.), 1 Hill 287; First National Bank of Minneapolis v. First City National Bank, 182 Mass. 130, 65 N.E. 24; Planters Bank & Trust Co. v. Fifth-Third Union Trust Co., 56 Ohio App. 309, 10 N.E. (2d) 935; See also Ames, The Doctrine of Price v. Neal, 4 Harv. L. Rev. 257, 301-302.

[8] "The right to recover is a quasi-contractual right resting upon the doctrine that one who confers a benefit in mis-reliance upon a right or duty is entitled to restitution." Woodward, Quasi Contracts, (1913) Sec. 80.

of the drawee had been forged, where a drawee sought to recover.[9] This rule, known as the rule of *Price v. Neal*[10] is thought to prevail by virtue of the law merchant independent of the Negotiable Instruments Law and also by virtue of Section 62 of the Negotiable Instruments Law.[11] When *Price v. Neal* was decided, the grounds for this exception to the principle of mutual mistake were not stated without ambiguity. It is difficult to determine whether the rationale was that of imposing absolute knowledge in the drawee of its depositor's signature thus rendering him negligent, or whether it is that of "yet there is no reason to throw off the loss from one innocent man to another innocent man."

Where it is the endorsement that is forged and not the signature of the drawee, the rule of *Price v. Neal* is said not to apply.[12] Barring other factors, a drawee bank is permitted to recover money paid out by it on a forged endorsement. Although there has been considerable doubt, recovery also is permitted where money is paid in a materially altered check.[13] The *Interstate Trust* case, the Court refused to apply to the missing endorsement situation, supports recovery on an altered instrument. Recovery is rationalized in these situations by the fact that it seems harsh to charge a bank with knowledge of the signature of prior endorsers, or with the original terms of the instrument.[14] If anyone is to be charged, it should be he who had the greatest opportunity to determine the validity of the endorsement.[15]

In the present case, the Court refused to apply the Negotiable Instruments Law. The basis for the discussion is nevertheless problematical. Initially Justice Alter seemed to base the opinion upon the negligence of the Defendant, Hereford, which resulted in the mistake of the drawee bank. Such a theory would not appear to be sound, for the drawee was equally at fault because the missing endorsement was patently apparent. If negligence were the basis then it could be said that the contributory negligence of the drawee should bar recovery. Apparently realizing this, emphasis was also placed upon contractual recovery

[9] Price v. Neal, 3 Burr. 1354.

[10] Footnote 9 *supra*.

[11] Colo. Rev. Stat., (1953) Ch. 95, Art. 1, Sec. 62; Britton, Bills and Notes, (1943) Sec. 135.

[12] State Planters Bank and Trust Co. v. Fifth-third Union Trust Co., *op. cit. supra*, note 7. The N.I.L. does not expressly deal with the problem, but the generally accepted common law rule is deemed to have been imported by virtue of Section 196 (Colo. Rev. Stat. (1953), Ch. 95, Art. 4, Sec. 7). For a collection of cases see Britton, Bills and Notes (1943), Sec. 139, Fn. 2.

[13] See Interstate Trust Co. v. United States National Bank, 67 Colo. 61, 185 P. 260. Rule 62 of the N.I.L. was not discussed in this case. See National City Bank of Chicago v. National Bank of Republic, 300 Ill. 163, 132 N.E. 832, and Wells Fargo Bank & Union Trust Co. v. Bank of Italy, 214 Cal. 156, 4 P. (2d) 781, which discuss the effect of Sec. 62 of the N.I.L. with respect to checks certified after alteration.

[14] Eg. Clearfield Trust Co. v. United States, 318 U.S. 363, 63 S. Ct. 573.

[15] *Ibid.*

where contributory negligence has not ordinarily been considered a defense:

> If Hereford is liable . . . , it must rest upon a contractual duty to return to plaintiff money which it has recovered and holds under mistake.

The decision would, then, appear to be consistent with quasi-contractual notions of recovery for mistake. However, the rationale for permitting recovery in forgery cases is that the drawee cannot be expected to have knowledge of a forged endorsement. Where one of two necessary endorsements is missing, a drawee may and perhaps should be charged with knowledge. The fact of its omission is apparent by a cursory examination of the instrument. As a matter of policy it could be argued that a bank must at least be held accountable for all patent irregularities on the back or face of a negotiable instrument.

The decision would have been more understandable had the Court not affirmed the dismissals as to both claims so far as the First National Bank was concerned; this unexplained affirmance is confusing in light of the fact that the reasoning which resulted in a reversal with respect to Hereford is equally applicable to the other Defendant. Perhaps the Court felt Hereford to be more at fault because it was the first endorsee on the check and accordingly should be more concerned with endorsements and endorsees than subsequent parties. But, where contractual principles are applied, comparative-rectitude would appear irrevelant.

The Court stated that the question was one of first impression in Colorado. Perhaps the only conclusion that can be reached with respect to the decision is that it fixes liability where an endorsement is missing; that the choice of the liable party was, in a sense, by virtue of nature of the question presented, an arbitrary choice. It would appear, perhaps, that the person or agency which first takes a check with a missing endorsement will be held liable regardless of the fact that all subsequent parties are guilty of the same sin.

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